November 6, 2013

ABATE's Comments Re Energy Efficiency:
Readying Michigan to Make Good Energy Decisions

The electric and natural gas industries have fundamentally changed since the enactment of Act 295 in 2008. These changes, which are not adequately acknowledged or discussed in the Draft Report, make it imperative that policy makers re-examine the need and the efficiency of requiring industrial customers to participate in utility-sponsored energy efficiency programs which are mandatorily funded through surcharges on utility rates under a system where the utility collects the dollars, requires customers to petition the utility for grants, subsidies and the like, and the utility determines which customers receive what amounts under the programs. The need for these mandatory programs aimed at industrial customers is not justified, and, on a going-forward basis, industrial customers should be allowed the opportunity to opt-out of participation in both electric and natural gas energy efficiency/optimization programs.

There are two principal reasons why mandatory programs do not make sense: industry changes and the inherent inefficiencies of mandatory programs administered by utilities and/or a designated third party. There is also a third reason, which has always existed, in that industrial customers are under intense global competitive pressures which require them to minimize their cost of production including becoming more energy efficient and the availability of greater internal resources which allows industrial customers to become more knowledgeable regarding energy efficiency opportunities related to their specific and sometimes unique production processes. Industrial customers are unlike other classes of utility customers in that their primary energy loads are related to their production systems, as opposed to more universal space heating and lighting applications which are the principle drivers for both residential and commercial energy usage.

Changing Trends in the Electric and Natural Gas Industries

Act 295 became effective in Michigan on October 6, 2008. At the time the Legislature was crafting Act 295, the following were the forecasted trends in the electric and natural gas industries:

- There was strong demand for all commodities including steel, concrete, plastics, chemicals.

- In response to increasing demand the commodity prices were moving upwards.

- Increased commodity prices were expected to raise the cost of the infrastructure necessary to provide energy to customers, including the cost of power plants, the cost of new gas mains, etc.

- Forecasts assumed that the U.S. would not be able to produce enough natural gas to keep up with domestic demand.

- Liquefied Natural Gas ("LNG") was thought to be necessary to supplement domestic supply, and arrangements were being made to create the necessary infrastructure to permit the import of LNG.

- According to the then *2008 Annual Energy Outlook*, published by the Energy Information Administration ("EIA"), the demand for natural gas would grow modestly in the U.S. where natural gas demand and the power generation sector offset declines in the use in the residential and commercial sectors.

- The EIA also projected that imported LNG would supply approximately 25% of the natural gas supply in the U.S.

- U.S. electric prices were high and would go even higher.

- Due to their cost, there were very few new central station fossil-fired or nuclear plants that were projected to be built.

- Energy conservation was necessary to meet power demand and was cheaper than the incremental cost of building new power plants.

The Great Recession Changed These Trends

- With the onset of the great recession in 2008, the demand for electricity and other fuels fell dramatically.

- The price of natural gas of the Henry Hub Gulf Coast Pricing Point spiked to over $12 per million BTU's in early 2008 and then began to decline.

- In 2007 LNG imports approached 100,000 million cubic feet before declining to under 40,000 million cubic feet in 2008.

- Industrial output plummeted.

- Residential gas use declined dramatically.

Current Trends and the *2013 Annual Energy Outlook (Early Release)*, EIA Forecast

- Crude oil production has increased from approximately five million barrels per day in 2008 to 7.5 million barrels per day in 2013.

- Dry natural gas production has increased from approximately 21 trillion cubic feet in 2008 to 24 trillion cubic feet in 2013.

- Electricity sales for the residential and commercial class have declined while industrial sector sales have increased.

- The nominal price for electricity has increased slightly for the residential class while holding steady for the commercial and industrial classes.

- The locational marginal price in the Midwest for electricity declined from approximately $70 per megawatt hour in July 2008 to approximately $40 per megawatt hour in July 2013.

- The NYMEX Henry Hub natural gas futures prices are projected to be approximately $4 per MMBTU in February, 2014 and not exceed $4.50 per MMBTU until December 2016.

Conclusions

- The trends allegedly supporting mandated industrial energy efficiency programs have not materialized.

- Actual energy prices in 2013 have been much lower than the prices projected in 2008.

- Global competition among industrial customers remains very strong, putting substantial pressure on industrial customers to cut their cost of production, especially the cost of energy.

- It is inefficient to incur the administrative and overhead costs of energy efficiency programs run by utilities for industrial customers, plus bonus payments to utilities, given the facts that: (1) industrial energy usage is unique to the sector involved; (2) in many instances, industrial energy uses involve proprietary and business-sensitive information; and (3) industrial customers have the ability to identify areas of energy saving and to implement programs to reduce energy costs without mandated utility and state-run energy efficiency programs.

- The reasons simply have not materialized for (1) requiring customers to apply to seek a grant; (2) implementing stringent reporting requirements; and (3) imposing penalties for missing energy efficiency savings targets. Therefore, industrial customers should have the freedom to opt-out of utility-sponsored energy efficiency programs and pay no other surcharges but for a surcharge perhaps to support low-income energy efficiency programs.